

Private Credit in 2026: Opportunity through Discipline

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The private credit market enters 2026 facing heightened scrutiny following a series of high-profile defaults in late 2025. Beneath the headlines lies a more nuanced reality: an asset class experiencing the natural growing pains of rapid expansion, one that fills a critical financing gap in the global economy. For investors who approach the market with rigor, transparency, and disciplined underwriting, the opportunities remain compelling.

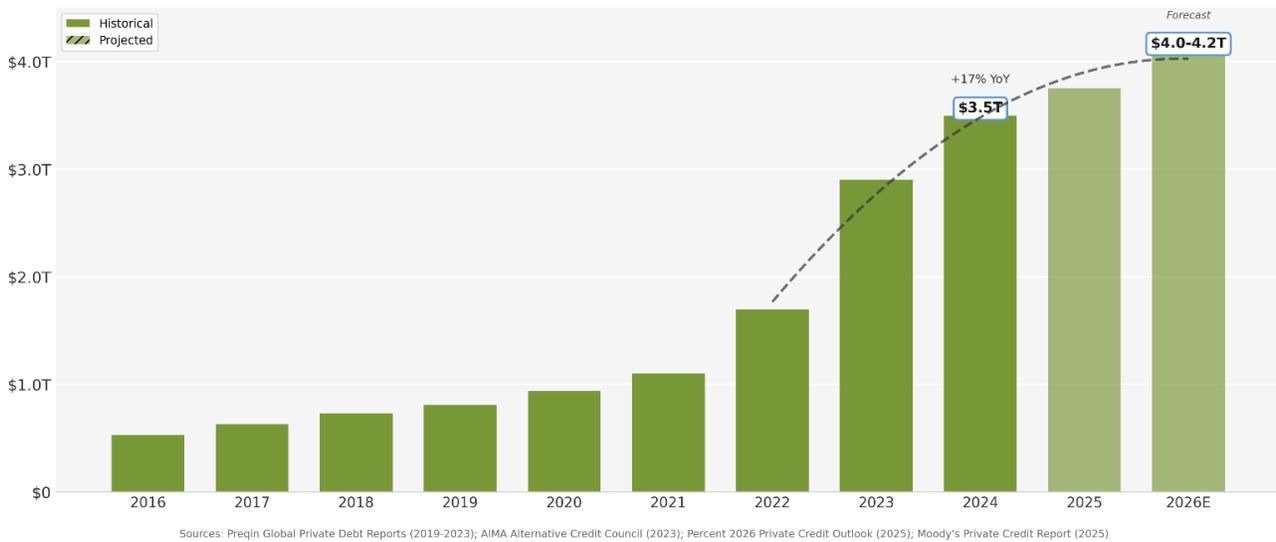
The Shifting Narrative

The private credit industry has witnessed remarkable growth, reaching approximately \$3.5 trillion in assets under management by the end of 2024, representing a 17% increase from the prior year [1]. Industry projections suggest this figure will climb to roughly \$4.0–\$4.2 trillion by the end of 2026, reflecting continued institutional allocation and expanding addressable markets [2] [3]. This trajectory has been driven by structural factors: the retreat of traditional bank lending following post-2008 regulations; borrower demand for flexible capital solutions; and investor appetite for income-generating assets.

However, September 2025 marked an inflection point. The near-simultaneous bankruptcies of auto-parts supplier First Brands and subprime auto lender Tricolor Holdings exposed not only individual company failures but also raised broader questions about underwriting discipline, valuation transparency, and interconnected risks across the financial system.

Global private credit market growth (2016-2026)

Assets Under Management (USD Trillions)



Addressing the Concerns

While private credit has demonstrated resilience, three interrelated risks warrant careful monitoring: weakening underlying credit quality, limited valuation visibility, and an upward default trend.

A significant indicator of market stress is the increasing use of payment-in-kind (PIK) features. This allows borrowers to defer cash interest by adding it to the principal. PIK transactions rose from 7.4% in 2021 to 10.6% by the third quarter of 2025 [4]. Additionally, "bad PIKs," which are added after the closing due to borrower distress, now constitute 57.2% of all PIK structures, up from just 36.7% in late 2021 [5]. This raises concerns that reported marks may overstate health, as approximately three-quarters of PIK exposure is valued at more than 95 cents, despite representing deferred obligations of financially strained borrowers.

At the same time, private credit valuation remains inherently opaque versus public markets because marks rely heavily on manager models and discretion, creating information asymmetry, especially in stress, prompting scrutiny from regulators such as the SEC, ECB, and U.S. DOJ over inconsistent practices (including cases where the same exposure is valued materially differently by different lenders).

Finally, defaults are no longer negligible: U.S. private credit defaults rose to about 5.7% by early 2025, from near zero in 2022 (with direct lending lower at around 1.5%) [9]. Although still well below the 2008 crisis, the increase is sufficient to test whether losses remain idiosyncratic or instead reflect broader late-cycle deterioration as policy conditions normalize.

The Case for Continued Private Credit Expansion

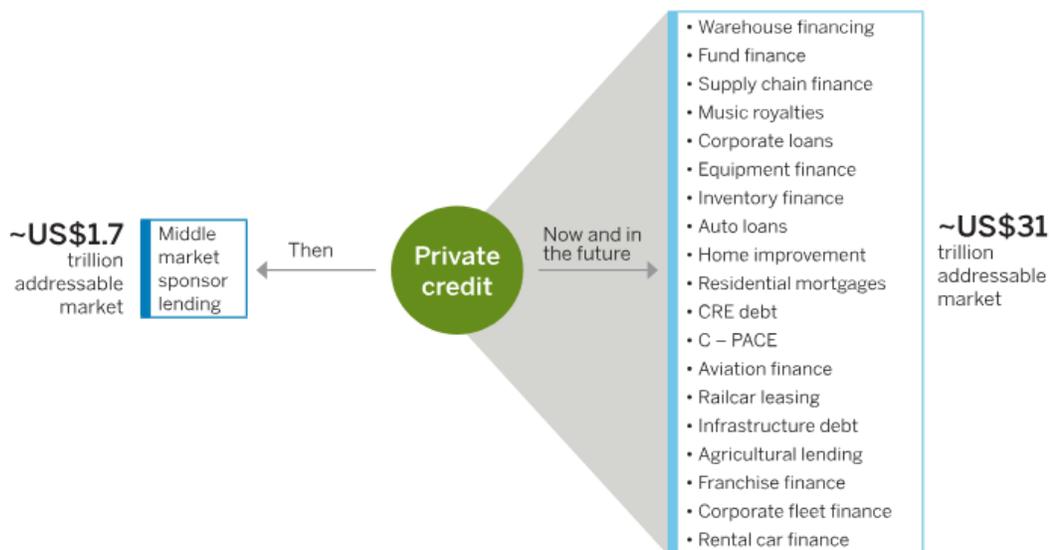
Acknowledging these concerns does not negate the asset class's fundamental value proposition, nor does it suggest a systemic crisis is imminent. Several factors support the asset class's continued growth and essential role in the financial ecosystem:

Structural Demand Persists

The addressable market for private credit exceeds \$30 trillion across diverse asset classes, well beyond the traditional leveraged corporate debt that dominates many portfolios today [11]. This opportunity set includes asset-backed finance, infrastructure lending, real estate debt, trade finance, and specialty sectors where traditional banks have permanently retreated. Borrowers increasingly prefer the flexibility, speed of execution, and certainty of private lenders over syndicated markets that can prove volatile and unreliable during periods of market stress.

Consider lending timelines: private credit transactions can close in weeks rather than the months required for syndicated deals, providing critical advantages when companies face time-sensitive opportunities or refinancing needs. Private credit fills a gap that public markets often cannot by providing tailored solutions to meet the borrower's specific requirements.

Private credit's US\$30+ trillion addressable market



Sources: Prequin, PWC research. | US\$31 trillion is the average of the forecasts made by seven of the largest private credit firms by assets under management.

Underwriting Quality Among Leading Managers

While isolated failures garner headlines, the broader data on private credit portfolios remains constructive. Q3 2025 fundamentals showed positive year-over-year EBITDA growth for companies generating over \$25 million in EBITDA [12]. Interest coverage ratios, while having declined from peak levels, remain above pre-pandemic norms for most borrowers.

Leading private credit managers maintain rigorous underwriting standards, including maintenance of covenants, amortization requirements, and structural protections largely absent from syndicated markets. By late 2025, spreads on lower-middle-market direct-lending deals were at SOFR+450 to SOFR+475, representing a 100–150-basis-point premium over syndicated markets with significantly stronger creditor protections [13]. This yield advantage, combined with robust structural safeguards, provides meaningful downside protection when combined with disciplined credit selection.

The Path Forward: Transparency, Discipline, and Partnership

The private credit market stands at a crossroads. Continued expansion is not guaranteed; it must be earned through demonstrated resilience, transparent reporting, and consistent performance across credit cycles. The industry's credibility depends on how participants respond to current challenges. Several imperatives emerge:

Enhanced Transparency in Valuation and Reporting

Private credit managers must move beyond minimum regulatory requirements to provide investors with granular portfolio data, including PIK exposure breakdowns, covenant compliance metrics, and realistic assessments of credit quality. Third-party valuations, particularly for complex or stressed assets, provide critical validation. Communicating regularly about changes in portfolios, sectors, and new risks makes investors feel more confident and gives them realistic expectations.

Rigorous Credit Discipline

The temptation during periods of excess capital and competition is to stretch on leverage, loosen covenants, or accept marginal credit quality to deploy capital. This approach inevitably leads to losses when cycles turn. Sustainable private credit investing requires maintaining underwriting standards regardless of competitive pressures, walking away from deals that don't meet return hurdles adjusted for risk, and prioritizing capital preservation alongside yield generation.

This discipline extends to structure. The maintenance of covenants should be the standard, not the exception. Amortization requirements force deleveraging and provide early-warning signals when companies struggle to generate cash flow. PIK features, when used, should be incorporated thoughtfully into original deal structures rather than retrofitted to rescue failing credits. Minimum cash pay requirements prevent borrowers from deferring all interest obligations.

Diversification Across Strategy, Sector, and Vintage

Concentration risk, whether individual borrowers, sectors, deal sizes, or origination vintage, amplifies portfolio vulnerability during stress periods. Thoughtful diversification across asset-backed finance, corporate direct lending, specialty finance, and other sub-strategies provide natural hedges as different segments outperform at various cycle stages.

Vintage diversification proves particularly important given the cyclical nature of credit performance. Loans originated during periods of aggressive competition, and elevated valuations tend to underperform, as borrowers were often willing to pay above-market prices for acquisitions financed with maximum leverage. Maintaining consistent deployment across vintages, rather than concentrating capital at cycle peaks, smooths return and reduces tail risk.

Private Credit's Role in Financing Solutions

The concerns currently facing private credit should not obscure its fundamental value as a financing tool for businesses and a return stream for investors. Just as renewable energy requires scalable, fast-track deployment solutions despite policy headwinds, growing companies require flexible capital partners who can navigate complexity and deliver execution of certainty. The question is not whether private credit will continue to grow; structural drivers ensure it will, but rather who will thrive as standards reset and risk management becomes the differentiating factor.

The road ahead for private credit requires acknowledging legitimate concerns while maintaining conviction about the asset class's structural advantages. Transparency, discipline, and partnership not opacity, aggressive growth, and transactional relationships—will define success in this next phase. For those willing to do the hard work of rigorous underwriting, proactive portfolio management, and honest communication with investors, private credit remains a compelling opportunity set in 2026.

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